

REPORT BY THE  
AUDITOR GENERAL  
OF CALIFORNIA

---

**STATUS REPORT ON THE SELECTION OF  
THE NEXT MEDI-CAL FISCAL INTERMEDIARY**

---

REPORT BY THE  
OFFICE OF THE AUDITOR GENERAL  
TO THE  
JOINT LEGISLATIVE AUDIT COMMITTEE

228.2

STATUS REPORT ON THE SELECTION OF THE  
NEXT MEDI-CAL FISCAL INTERMEDIARY

OCTOBER 1982



# California Legislature

## STAFF

WALTER J. QUINN  
CHIEF CONSULTANT  
ROBERT W. LUCAS  
PRINCIPAL CONSULTANT  
CHARLES T. SCHULTZ  
SENIOR CONSULTANT  
GWEN YOUNKER  
COMMITTEE SECRETARY

## Joint Legislative Audit Committee

925 L STREET, SUITE 750  
SACRAMENTO, CALIFORNIA 95814  
(916) 445-0371

**WALTER M. INGALLS**  
CHAIRMAN

SENATE MEMBERS  
ALFRED E. ALQUIST  
RUBEN S. AYALA  
ROBERT G. BEVERLY  
PAUL CARPENTER  
JOHN DOOLITTLE  
KEN MADDY  
VICE CHAIRMAN  
ROBERT PRESLEY

ASSEMBLY MEMBERS  
LEROY F. GREENE  
CHARLES IMBRECHT  
ERNEST KONNYU  
RICHARD ROBINSON  
MARILYN RYAN  
JOHN VASCONCELLOS

October 15, 1982

228.2

The Honorable President pro Tempore of the Senate  
The Honorable Speaker of the Assembly  
The Honorable Members of the Senate and the  
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's report concerning the Health and Welfare Agency's efforts to select the next fiscal intermediary for processing Medi-Cal claims.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Walter M. Ingalls".

WALTER M. INGALLS  
Chairman, Joint Legislative  
Audit Committee

## TABLE OF CONTENTS

	<u>Page</u>
SUMMARY	i
INTRODUCTION	1
AUDIT RESULTS	
I    STATUS OF THE PROCUREMENT PROJECT	7
II   DECISION TO EXTEND THE PRESENT CONTRACT	12
III  AUDITOR GENERAL'S MONITORING OF THE MEDI-CAL PROCUREMENT PROJECT	26
CONCLUSION	28
RESPONSE TO THE AUDITOR GENERAL'S REPORT	
Medi-Cal Procurement Project, Health and Welfare Agency	30
APPENDIX	
SYNOPSIS OF MAJOR POLICY DECISIONS	A-1

## SUMMARY

The Health and Welfare Agency's Medi-Cal Procurement Project (MCPP) is responsible for conducting a procurement for the next Medi-Cal fiscal intermediary to process Medi-Cal claims. In this report we discuss the current status of the MCPP and our monitoring of the project. The report consists of three parts. First, we provide information on the overall status of the procurement project. Second, we report the status of the agency's implementation of our recommendations concerning an extension of the current fiscal intermediary contract. Finally, we describe our efforts to monitor the procurement project. In addition, in an appendix, we provide a synopsis of the major policy decisions made to date regarding the procurement process.

The Medi-Cal Procurement Project is underway and fully staffed. MCPP management have established the following major milestones for the project: issuing the final Request for Proposal, March 1, 1983; awarding the contract, September 1, 1983; and seeing the next contractor fully operational, March 1, 1985. These milestones assume that the current fiscal intermediary contract will be extended for up to 12 months.

In May 1982, the Compass Consulting Group, Inc., under contract with the MCPP, released its Medi-Cal Fiscal Intermediary Reprocurement Study, which included a recommended schedule for the procurement project. Although the project did not meet two of the consultant's recommended milestones, the review of the documentation of the current claims-processing system for bidders and full MCPP staffing, it is too early to know whether these delays will affect the overall project schedule. The consultant's schedule provided for two two-month contingency periods, and MCPP staff have subsequently revised the project schedule.

Although the MCPP staff had originally recommended extending the current fiscal intermediary's contract for 12 months in order to ensure the accomplishment of all procurement steps, the MCPP has not made a formal decision to ask the Department of Health Services to extend the contract. The MCPP management believe that no decision on an extension can legally be made until the last six months of the current contract. Nevertheless, the MCPP's current project schedule assumes that an extension of up to 12 months is necessary (10 months plus a two-month contingency). In addition, the MCPP does not know the complete status of the documentation of the current claims-processing system. However, the deputy director of the Fiscal Intermediary Management Division has stated that when

the review of the documentation is complete, his division will take appropriate action to ensure that the CSC makes any needed improvements required by the contract.

As part of our monitoring responsibility, we reviewed the MCPP's original recommendation on the 12-month extension and found that the MCPP staff had not gathered enough information in four areas to decide on the need for such an extension. We shared this observation with the MCPP management in June 1982, and the MCPP agreed to postpone the decision. The MCPP staff have since completed work in these areas, and the MCPP management believe that at least a 10-month extension will be necessary. However, if the documentation for the current claims-processing system is unacceptable for review by potential bidders, the MCPP director stated that he may allow bidders to submit contract bids on systems other than the one currently in operation. If this situation occurs, MCPP management indicated they will have to reevaluate the need for and length of a contract extension.

This is the third report we have issued during the course of our monitoring of the MCPP. As part of this monitoring, we have attended the meetings of the MCPP's Policy Advisory Committee, analyzed policy issues, and performed an informational survey of the Request for Proposal. We found

that the current contract needs improvement in several areas and believe that the new Request for Proposal should be improved in these areas. The areas in question are the method of payment to the contractor, change orders and enhancements, performance standards, and liquidated damages. Accordingly, we have begun analyzing these areas and have shared our preliminary concerns with the MCPP.

We will monitor the MCPP's development of these areas in the Request for Proposal, and we will continue to share our observations on these and other contractual areas. We will also monitor the State's implementation of recent Medi-Cal reform legislation that can affect current and future operations of the fiscal intermediary and the nature of the contract. And finally, after the Request for Proposal has been issued, we plan to monitor the subsequent phases of the Medi-Cal Procurement Project.

During the course of the project, the MCPP management have made numerous policy decisions that will affect either the process of procuring the next fiscal intermediary or the terms and conditions of the new contract. We have provided a synopsis of these major policy decisions in an appendix. Although the MCPP has made no decision on requiring performance

standards for the accurate payment of Medi-Cal claims, we believe that this is an important issue and should be given further consideration.

## INTRODUCTION

In response to a request by the Joint Legislative Audit Committee and language contained in the supplemental report of the Budget Act of 1982, we are monitoring the Health and Welfare Agency's (agency) project to select the next Medi-Cal fiscal intermediary. We conducted our review under the authority vested in the Auditor General by Section 10500 et seq. of the Government Code.

This report discusses the status of the agency's project and our monitoring efforts. The report consists of three parts. First, we provide information on the overall status of the procurement project. Second, we report on the extent of the agency's implementation of recommendations we made concerning an extension of the current fiscal intermediary contract. Finally, we describe our efforts to monitor the procurement project. In addition, in Appendix A we provide a synopsis of the major policy decisions made to date by project management.

This is the third Auditor General report since we assumed responsibility for monitoring the fiscal intermediary procurement project. Our first report, which was addressed to

the project director in June 1982, identified several areas in which the Medi-Cal Procurement Project staff needed to complete additional work before determining whether a 12-month contract extension is necessary. The second report, Letter Report 228.4, provided data on expenditures for the operations of the current fiscal intermediary and on lost federal financial participation.

#### BACKGROUND

Since the Medi-Cal program was implemented in 1966, a nongovernmental fiscal intermediary, under contract to the State, has processed Medi-Cal claims and performed various payment activities. Medi-Cal Intermediary Operations held the first fiscal intermediary contract on a no profit/no loss basis; that is, the State reimbursed Medi-Cal Intermediary Operations for the costs it incurred. With the Legislature's concurrence, the Department of Health Services decided in 1976 to seek competitive bids for a new fiscal intermediary system. This effort resulted in the State's awarding the current contract to the Computer Sciences Corporation (CSC) for an estimated \$129.6 million.\* This contract became effective

---

\* This figure is based on anticipated claim volumes and is thus an approximation. It excludes certain items such as postage, for which the contractor is reimbursed.

September 1, 1978, and is scheduled to terminate on February 29, 1984. The contract also provides for a one-year extension at the State's option.

The new fiscal intermediary system was intended to increase the financial responsibility of the contractor and to establish a more efficient and effective claims-processing system. Additionally, the new fiscal intermediary system was intended to strengthen the State's management of the project and to ensure that the State had the option of operating the claims-processing system itself. While the current contract has met some of the State's objectives, achieving these objectives has caused considerable difficulties for the State, the CSC, and the providers of Medi-Cal services.

In order to procure the next fiscal intermediary, the State established a task force to develop the Request for Proposal. An interagency agreement, effective October 1, 1981, shifted responsibility for the procurement effort from the Director of the Department of Health Services to the Secretary of the Health and Welfare Agency (agency). The agreement also provided for staffing and funding for the Medi-Cal Procurement Project (MCPP) within the agency and for a management

consulting contract. The MCPP is responsible for drafting the new Request for Proposal, evaluating contract proposals, and phasing in the next contractor.

In November 1981, the State awarded the consulting contract to the Compass Consulting Group, Inc., which in May 1982 released a final report entitled the Medi-Cal Fiscal Intermediary Reprocurement Study. This study included an analysis of contract methodologies, competitive bidding approaches, and contractual performance issues. The study also provided a plan for the procurement project and a list of tasks required for the transition to the next fiscal intermediary.

To assist the MCPP staff in procuring the next contractor, the director of the MCPP established a Policy Advisory Committee.\* This committee met bi-monthly from the end of May through August 1982 to discuss issues presented by MCPP staff and to provide policy direction to MCPP management. The MCPP director and the Deputy Director of the Department of

---

\* The Policy Advisory Committee consists of representatives from the Departments of Health Services, Finance, and General Services; the Attorney General's Office, the State Controller's Office, the Health and Welfare Agency Data Center, and the County Supervisors Association of California. The Office of the Auditor General and the Federal Health Care Financing Administration have attended meetings but are not members of this committee.

Health Services' Fiscal Intermediary Management Division then make the final decision after considering the comments of the Policy Advisory Committee.

#### SCOPE AND METHODOLOGY

During the course of our monitoring of the Medi-Cal Procurement Project, we have expressed and will continue to express our concerns to MCPP officials on various procurement issues. However, our role as an independent oversight agency precludes either our participating in actual project decision-making or our approving the adequacy of the MCPP's work. From an auditing perspective, such approval can only be gained through formal auditing procedures conducted according to established governmental auditing standards. These standards state that positive assurance can be provided only when audited items have been found to be in compliance with applicable laws and regulations. Such assurances can be given only upon completion of a formal, after-the-fact audit review rather than through monitoring.

During the phase of our monitoring culminating in this report, we reviewed the contract with the existing fiscal intermediary to determine the State's current contractual requirements. In order to determine the advisability of implementing various options in the new contract, we examined

the procurement study prepared by the Compass Consulting Group, Inc., and reviewed previous Auditor General reports. We also examined state and federal laws and regulations to determine the requirements of the Medi-Cal program, and met with officials of the Federal Health Care Financing Administration and the Department of Health Services' Fiscal Intermediary Management Division.

Additionally, we interviewed staff from the Department of Health Services' Office of Legal Services, the Attorney General, and selected Legislative committees. Also, we met with members of the MCPP staff to determine the status of the project and the work completed. We attended MCPP Policy Advisory Committee meetings to monitor the development of policy decisions, and we reviewed MCPP memoranda dealing with various issues of the project.

In the following section, we discuss the status of the procurement project, status of the MCPP's implementation of the Auditor General's recommendations on extending the current fiscal intermediary contract, and the Auditor General's monitoring efforts.

## AUDIT RESULTS

I

### STATUS OF THE PROCUREMENT PROJECT

The Medi-Cal Procurement Project (MCPP) is underway and fully staffed. MCPP management have established the following major milestones for the project: (1) release of the final Request for Proposal, March 1, 1983; (2) contract award, September 1, 1983; and (3) full operation of the next contractor, January 1, 1985. These milestones assume that the current fiscal intermediary contract may be extended for up to 12 months.\* In addition, MCPP staff are completing the analysis of policy issues that the MCPP needs to resolve in order to draft the Request for Proposal. MCPP staff have also begun drafting portions of the Request for Proposal.

In its procurement study, the Compass Consulting Group, Inc., provided an overall schedule for the procurement project. Although the project has been delayed in meeting two of the consultant's recommended milestones, it is too early to determine whether these delays will affect the overall project

---

\* We address this issue in the next section of this report.

schedule because the consultant's schedule also provided for two two-month contingency periods for unforeseen delays. MCPP staff have accordingly completed revised project schedules.

The first milestone that was not met in a timely manner involved the initiation of the Fiscal Intermediary Management Division Monitoring Project. In July 1982, the Department of Health Services awarded a contract to the Compass Consulting Group, for \$832,770. The purpose of this contract is to provide the State with a more effective plan for monitoring the fiscal intermediary. The Compass Consulting Group is subcontracting with the firm of Peat, Marwick, Mitchell & Co. to perform this work, which is known as the Fiscal Intermediary Management Division Monitoring Project. In addition, the consultants will review the current computer system, including program materials, and assist the State in ensuring that a new contractor can understand and operate the present system. Specifically, the consultants are required to do the following:

Perform a thorough and complete evaluation of the systems documentation required under the FI [fiscal intermediary] Contract to determine whether the Systems Documentation prepared by CSC [Computer Sciences Corporation] is complete, accurate, internally consistent, and current and accurately reflects the Medi-Cal claims processing system as it is being operated by CSC.

Originally, the Compass Consulting Group's procurement study scheduled the Fiscal Intermediary Management Division Monitoring Project to begin on June 1, 1982, and to be completed by December 1, 1982. However, MCPP staff stated that the project was delayed over a month for two reasons: first, funding for the contract was initially denied because of the Governor's hiring freeze that was in effect at the time; and second, after an exemption to the freeze was approved, final approval of the contract was delayed at the Department of General Services. As a result of these delays, the consultants have prepared a revised workplan. As outlined in this plan, the consultants will provide the findings of their systems documentation review to the State in a series of reports concluding with a final report on December 17, 1982. It is uncertain whether postponing the original completion date of December 1, 1982, will affect the overall procurement schedule.

The other milestone delayed in being met was the date scheduled for the MCPP to have a full staff of 25 persons. In its procurement study, the Compass Consulting Group recommended that the MCPP be fully staffed by July 1, 1982. However, the project was not fully staffed until August 1, 1982. MCPP management stated that the time allotted by the Compass Consulting Group for hiring new staff was insufficient; even so, they tried to complete the hiring of all staff members

as soon as possible. This delay may affect the extent of the analysis of issues performed for the Summary Preview Request for Proposal (a preliminary draft); however, it is uncertain whether this delay will affect the final Request for Proposal.

The MCPP staff, most of whom are data processing and government program analysts, have identified, ranked, and researched procurement issues and addressed these major policy areas in a series of memoranda issued to the Policy Advisory Committee for discussion. In addition to identifying the issues to be discussed, these memoranda also provide background information, analysis, and staff recommendations. This process is nearly complete and the staff are now developing the Summary Preview Request for Proposal, scheduled for release on October 12, 1982. This Summary Preview Request for Proposal will address both conceptual issues and specific contract provisions and will be distributed for comment to potential bidders, state control agencies, the Health Care Financing Administration, provider associations, legislative committees, and other interested groups. The schedule on the following page, which assumes that an extension of up to 12 months is needed, illustrates the MCPP's current milestones for releasing the Request for Proposal (RFP) and for transferring operations to the next fiscal intermediary.

MEDI-CAL PROCUREMENT PROJECT  
CURRENT SCHEDULE

<u>Milestones</u>	<u>Estimated Completion Date</u>
Summary Preview RFP Released	October 12, 1982
Draft RFP Released	January 4, 1983
Final RFP Released	March 1, 1983
Technical Proposal Preparation	May 16, 1983
Technical Proposal Evaluation	July 31, 1983
Invitation for Bid Issued	August 1, 1983
Contract Awarded	September 1, 1983
Contract Signed and Approved	October 1, 1983
Transition	February 1, 1984
State Acceptance Testing	June 1, 1984
Expiration of the CSC Contract	December 31, 1984

The above schedule includes a two-month contingency period after the December 31, 1984, expiration date of the CSC contract. This period is half the four-month contingency time originally scheduled by the Compass Consulting Group.

DECISION TO EXTEND  
THE PRESENT CONTRACT

Management personnel of the Medi-Cal Procurement Project have not formally decided to recommend to the Department of Health Services an extension of the current fiscal intermediary's contract for several reasons. First, MCPP management believe that no decision on an extension can legally be made until the last six months of the current contract. In addition, MCPP management do not want to commit the State to an extension until the documentation of the current system is considered satisfactory and ready for review by potential bidders. Nevertheless, as we have previously indicated, the MCPP's schedule assumes that an extension of up to 12 months is necessary (10 months plus a two-month contingency).

In June 1982, the MCPP staff recommended to the Policy Advisory Committee that the existing contract with the Computer Sciences Corporation (CSC) be extended for 12 months beyond the scheduled termination date of February 29, 1984. The MCPP staff based their recommendation on the analysis conducted by the Compass Consulting Group, whose procurement study reported that a one-year extension of the current

contract is required to complete all the steps necessary to develop a Request for Proposal, select a contractor, transfer claims-processing responsibilities, and test the system.

On August 31, 1982, the director of the MCPP stated that no decision on the contract extension could legally be made until the last six months of the current contract because the current contract states as follows:

In the event that the State is delayed during the last 6 months of this contract by causes other than the Contractor or its subcontractors in phasing out the services provided by the Contractor, the Contractor shall provide operation services for a period not to exceed 12 months from the expiration date of this contract....

MCPP management have indicated that project staff are trying to reduce the time required to make the next fiscal intermediary operational and may accomplish this task in less than 12 months; however, they believe that at least a 10-month extension will be necessary. MCPP management believe that the State has the option of exercising a 12-month extension to perform properly all the tasks involved in procuring the next fiscal intermediary. However, if the documentation for the current claims-processing system is unacceptable for review by potential bidders, the MCPP director stated that he may allow bidders to submit contract bids on systems other than the one

currently in operation. If this situation occurs, MCPP management indicated they will have to reevaluate the need for and length of a contract extension.

As part of our monitoring responsibility, we initially attempted to evaluate the need for a contract extension and to determine how long such an extension should be. We found, however, that the MCPP staff had not gathered enough information in this area, and we were unable to reach a conclusion regarding the need for or length of a contract extension. In a letter to the MCPP director (Management Letter 228.1; June 11, 1982), we identified four areas in which the MCPP staff needed to complete additional work: (1) documentation of the present claims-processing system; (2) cost of extending the present contract; (3) allowing contract bids on functionally equivalent systems; and (4) time and staffing requirements for preparing the Request for Proposal and ensuring that the next fiscal intermediary is operating. We also stated that MCPP staff could perform this work until as late as September 1, 1982, without adversely affecting the overall mission of the MCPP. MCPP management concurred and agreed to postpone the decision on the contract extension until the MCPP staff completed the additional work. The following sections describe in detail each of four areas we identified as needing additional work.

Documentation of the Present  
Claims-Processing System

The implementation and operation of the Medi-Cal claims-processing system involves computer programs and their documentation. Material containing all programming, system, and logic information that is necessary to process Medi-Cal claims is known as "system documentation." Prospective bidders review the system documentation to understand how the system operates, to prepare technical proposals, and to offer bids to the State. If the system documentation does not adequately represent the system, a bidder may file a protest stating that inadequate system documentation prevented fair and equitable competition for the contract. Any such protest could delay the bidding process. Moreover, the Federal Health Care Financing Administration has the authority to disapprove a contract if it determines that bidders did not have an equal and fair chance to compete.

The Department of Health Services' Fiscal Intermediary Management Division is responsible for managing the current contract and is therefore directly responsible for the status of system documentation. Because the status of this documentation is critical to the procurement effort, it is a concern of the MCPP.

When we reviewed the MCPP earlier this year, the State knew neither the condition of the system documentation nor whether it was adequate for review by bidders. To determine the condition of the system documentation and to identify any deficiencies, the Department of Health Services contracted with a consortium of consultants, the Compass Consulting Group, Inc., and Peat, Marwick, Mitchell & Co. In our review, we identified several problems with the State's efforts to assess the condition of the system documentation.

First, the MCPP staff had not established criteria to measure the adequacy of the system documentation as it was reported by the consultants and therefore could not identify critical corrections that would have to be made before the Request for Proposal is released and bidders begin their review. Second, unless MCPP management asked the Department of Health Services to direct the consultants to conduct an immediate overview of the system documentation, the MCPP staff would not know the general condition of the system documentation and, thus, would not be able to estimate accurately the amount of time necessary to correct deficiencies. Consequently, corrective actions could be delayed, thus lengthening the procurement process. Finally, the MCPP did not have a plan to ensure prompt correction of deficiencies. The prompt execution of such a plan would enable

the State to identify all delays for which the Computer Sciences Corporation (CSC) is responsible, and thus allow the State to negotiate more effectively a contract extension with the CSC.

Because of our concerns, we recommended that the MCPP staff take the following three steps: (1) establish criteria to determine whether system documentation is adequate for bidder acceptance; (2) assess the condition of system documentation as soon as possible by asking the Department of Health Services to direct the consultants to perform an overview of the entire system before proceeding with the detailed review; and (3) ask the Department of Health Services to develop a plan for the prompt correction of any deficiencies found during the review of the system documentation.

In response to these recommendations, the MCPP staff have determined that 12 items of documentation will be required for bid purposes and that these items will be evaluated according to completeness, currency, and usability. Also, the director of the MCPP asked the deputy director of the Fiscal Intermediary Management Division to request that the consultants conduct a summary overview of the system documentation. On August 10, 1982, the consultants reported the status of this overview and described the methodology they used. Although the consultants' overview proved to be

inconclusive, the MCPP's data processing manager determined that the quality of California's system documentation is at least that of New York's. New York, which has recently undergone a fiscal intermediary procurement process, experienced no bidder protests. Finally, although no plan has been designed to correct any inadequacies identified in the system documentation, the deputy director of the Fiscal Intermediary Management Division has stated that, when the review of the documentation is complete, his division will take appropriate action to ensure that the CSC makes any needed improvements required by the contract.

Cost of Extending  
the Present Contract

Under the present contract, the State pays the Computer Sciences Corporation (CSC) a contracted rate for every Medi-Cal claim processed. Additionally, the State pays for other costs, such as postage and printing. If the current contract is extended, the State will continue to pay the CSC the contracted rate as adjusted by any change in the California Consumer Price Index. The State will also pay any other costs that might be applicable to the contract. At the time of our earlier review, we found that the staffs of the MCPP and the Department of Health Services had not estimated the cost of extending the current contract with the CSC.

The Federal Health Care Financing Administration (HCFA), which is responsible for approving all contract extensions, has denied extensions of fiscal intermediary contracts in Tennessee and Kansas because the HCFA believed the costs of these extensions were too great. Since the MCPP staff must submit the proposed contract extension to the HCFA for approval, the staff should attempt to estimate the cost of extending the contract. This will allow the MCPP to address more adequately any federal concerns about costs. Without such cost information, the HCFA could delay its approval indefinitely while it develops its own estimate of the cost of the proposed extension.

Additionally, before the MCPP staff can make a recommendation to the DHS on the length of a contract extension, the staff should know the fiscal impact of all the alternatives to an extension. By estimating the costs of extending the contract for various lengths of time, the MCPP staff may determine that one extension alternative is fiscally more attractive than others. Such a determination could affect the time needed to procure the next contractor.

Therefore, in our letter of June 11, 1982, we recommended that the MCPP staff estimate the fiscal impact of various contract extension alternatives and determine their effect on the length of the procurement process. In addition,

we recommended that the MCPP staff contact officials at the HCFA headquarters to determine their official position on a contract extension.

The MCPP staff have estimated that fiscal intermediary services under a one-year contract extension will be approximately \$28.6 million. In their analysis, the MCPP staff identified several elements that could affect this estimate. For example, State-required changes in the fiscal intermediary's operations, which will be implemented before the end of the extension period, will affect the cost. Also, assessments by the State for nonperformance by the contractor have resulted in funds held in dispute. The amounts that will be involved in the resolution of these disputes are currently unknown. Additionally, new legislation could result in a lower volume of Medi-Cal claims and affect costs by raising the payment rate for processing fewer Medi-Cal claims. Furthermore, the MCPP staff said that changes in the California Consumer Price Index may affect the cost estimate.

Finally, to ascertain the federal government's official position on a contract extension, the deputy director of the Fiscal Intermediary Management Division submitted a written request to the HCFA Region IX office in San Francisco in June 1982. The HCFA Associate Regional Administrator, in an

October 4, 1982 reply, stated that the HCFA would not object to the State's using the extension option under appropriate circumstances during the last six months of the CSC contract.

Allowing Contract Bids on  
Functionally Equivalent Systems

For a state to qualify for maximum federal funding, that state's claims-processing system must meet federal certification standards. To date, the federal government has certified most of California's system, thus making the State eligible for 75 percent federal financial participation instead of only 50 percent funding. Some states, however, maintain systems that are not certified; these states, therefore, do not receive maximum federal funding. At least one state seeking a new fiscal intermediary contract has allowed competing companies to propose systems that are similar to, but not the same as, the system currently in operation. Such similar systems are known as "functionally equivalent systems."

In its procurement study, the Compass Consulting Group developed a schedule for the State's procurement process, assuming that the State would not allow companies to propose functionally equivalent systems for processing claims. Representatives of the Compass Consulting Group have indicated that the bidding of functionally equivalent systems would

increase the time required for the procurement project. Specifically, the State would need additional time to evaluate contractors' proposals since these proposals could involve systems that are unfamiliar to state personnel. Also, transfer, transition, and testing of the system could take more time if the State selected a functionally equivalent system.

At the time of our review earlier this year, the MCPP staff had not decided whether to allow bids on functionally equivalent systems, nor had the MCPP staff obtained the federal government's position on this issue from the HCFA. We therefore recommended that the MCPP staff contact officials at the HCFA headquarters regarding functionally equivalent systems.

The MCPP staff have since decided not to allow bids on functionally equivalent systems. Consequently, they do not think it is necessary to contact the HCFA headquarters regarding this decision because they believe that the HCFA would only be concerned if the State decided to allow bids on functionally equivalent systems. The MCPP staff believe that the continued operation of the present system best assures the continuity of federal certification and federal funding.\* As

---

\* They also believe that operating the present system facilitates the delivery of Medi-Cal services, satisfies providers' needs, and better assures the timely processing of claims.

stated earlier in this report, the State may allow bids on functionally equivalent systems if the system documentation proves to be inadequate for review by bidders.

Time and Staffing  
Requirements for Preparing  
the Request for Proposal

The Compass Consulting Group's procurement study identified 26 tasks that must be performed in order to select and make operational the next fiscal intermediary. The consultants provided a Program Evaluation Review Technique chart that lists these tasks sequentially along a critical path and that identifies the projected dates for their completion based upon a 12-month extension of the existing contract. The consultants also provided a brief description of each task and estimated the time, by type of staff, necessary to complete each task on schedule. However, in our initial review, we found problems in three aspects of the consultants' time and staffing estimates.

First, the critical path for developing the final Request for Proposal was questionable. We found gaps and time unaccounted for on the schedule, and we found that insufficient time was allowed for some tasks. Second, certain task components seemed to be insufficiently defined either for making appropriate staff assignments or for estimating how long

the tasks would take to complete. Finally, the consultants provided only the total number of hours required to complete each task; they did not estimate the number and type of personnel necessary to perform each task according to a specific schedule. Our preliminary analysis indicated that the design phase of the Request for Proposal may be overstaffed in some job classifications and understaffed in others.

Because of the weaknesses in the consultants' Program Evaluation Review Technique chart, we recommended that the MCPP management complete the following to estimate how long the extension should be and to better plan the procurement project: (1) review the schedule proposed by the Compass Consulting Group and correct all deficiencies and errors found; (2) define more explicitly the tasks to be performed and estimate more accurately the time and staff necessary to complete these tasks; and (3) schedule all staff positions and the specific tasks that staff members will perform throughout the procurement project.

As of September 10, 1982, the MCPP staff had not analyzed the time and resources available in order to estimate the length of a contract extension. However, MCPP management had scheduled the time necessary to complete specific tasks by individual staff members through the issue analysis stage of

the Summary Preview Request for Proposal. Specifically, the MCPP management have also developed a schedule identifying the major project milestones. Further, by analyzing and modifying the Compass Consulting Group's report, the MCPP staff have listed the tasks necessary to complete the Request for Proposal.

MCPP management said that they have defined, to the best of their ability given the time constraints, the project tasks that need to be completed, and they have outlined the dates by which these tasks should be accomplished. These officials also stated that the current schedule will allow the staff to spend as much time as possible analyzing the Request for Proposal and testing the proposed system.

### III

#### AUDITOR GENERAL'S MONITORING OF THE MEDI-CAL PROCUREMENT PROJECT

As stated previously, this is the third report the Auditor General has issued since assuming responsibility for monitoring the fiscal intermediary procurement project. The first report, a management letter addressed to the MCPP director, analyzed issues pertaining to extending the current fiscal intermediary contract. The second report, produced in response to a supplemental request, provided the Legislature with expenditure data related to the current contract.

In addition to performing the above work, we have attended Policy Advisory Committee meetings, analyzed and commented upon other policy issues, and performed an informational survey related to the new Request for Proposal. Our survey work indicated that the current contract needs improvement in several areas and that the new Request for Proposal should include these improvements. The areas in question are the method of payment to the fiscal intermediary, change orders and enhancements, performance standards, and liquidated damages. Accordingly, we have begun to analyze these areas and have shared our preliminary concerns with the MCPP. We will continue to share our observations in these and

other contractual areas, and we will monitor the MCPP's development of the new Request for Proposal to see that it addresses these areas.

Our survey work also indicated the need for us to monitor the State's implementation of recent Medi-Cal reform legislation, such as AB 799 (Chapter 328, Statutes of 1982) and AB 3480 (Chapter 329, Statutes of 1982). Such legislation can affect current and future operations of the fiscal intermediary and the nature of the contract. Our preliminary review found that the Department of Health Services had begun implementing legislatively mandated program changes by submitting written instructions regarding such changes to the fiscal intermediary. In addition, the MCPP staff plan to cite certain Medi-Cal reform legislation in the Summary Preview Request for Proposal.

However, we remain concerned that all Medi-Cal reform legislation be incorporated into either the present fiscal intermediary system or the new Request for Proposal, whichever is appropriate. To this end, we intend to monitor the State's implementation of the legislation in question. When the MCPP issues the new Request for Proposal, we plan to monitor such activities as the MCPP's evaluation of bidder proposals and the development and use of the Invitation for Bid.

## CONCLUSION

The Medi-Cal Procurement Project (MCPP) is underway and fully staffed. MCPP management have established milestones over the course of the project assuming that the current fiscal intermediary contract will be extended for up to 12 months. In May 1982, the consultant under contract with the MCPP released its Medi-Cal Fiscal Intermediary Reprocurement Study, which included a recommended schedule for the procurement project. Although delays precluded the project from meeting two of its scheduled milestones, the review of the documentation of the current claims-processing system for bidders and full MCPP staffing, it is too early to know whether these delays will affect the overall project schedule.

The MCPP has not formally decided to make a recommendation to the DHS on a contract extension because of perceived legal constraints. The MCPP management believe that no decision on an extension can legally be made until the last six months of the current contract. In addition, the MCPP does not know the complete status of the documentation of the current claims-processing system. However, the deputy director of the Fiscal Intermediary Management

Division has stated that when the review of the documentation is complete, his division will take appropriate action to ensure that the CSC makes any needed improvements required by the contract.

We will continue to monitor the entire fiscal intermediary procurement project, concentrating our immediate efforts on the drafting of the Request for Proposal.

Respectfully submitted,



Thomas W. Hayes  
THOMAS W. HAYES  
Auditor General

Date: October 12, 1982

Staff: Robert E. Christophel, Audit Manager  
Samuel D. Cochran  
Mark A. Lowder  
Janet L. McDaniel  
Richard Larrouy



## HEALTH and WELFARE AGENCY

OFFICE OF THE SECRETARY  
1600 NINTH STREET, ROOM 460  
Sacramento, California 95814  
(916) 445-6951

October 7, 1982

Douglas X. Patino  
SECRETARY

Mr. Thomas W. Hayes  
Auditor General  
Office of the Auditor General  
660 J Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Hayes

Thank you for the opportunity to respond to your "Status Report on the Selection of the Next Medi-Cal Fiscal Intermediary". I appreciate your staff's approach in analyzing and commenting on issues before the issues were finally resolved. I look forward to a continuing good relationship with the Office of the Auditor General throughout the Medi-Cal procurement effort.

The following are our comments on the report:

#### SCHEDULE

The length of time required for this procurement is an important question for many involved organizations including the Administration, the Legislature, potential bidders, the federal government and Medi-Cal providers. The procurement effort involves a number of sequential steps each of which have significant impact on the award and administration of the contract. These steps include:

- 1) Drafting the Request for Proposal which specifies all contractual requirements.
- 2) Bidders' preparation of proposals which specify how they will do the work.
- 3) Requests and receipt of price bids, award and approval of the contract.
- 4) Contractor transition potentially including securing a facility, installing equipment, hiring staff and installation and testing of the computer programs.
- 5) State acceptance testing.
- 6) Gradual phase-in of claims processing.

Mr. Thomas W. Hayes  
10/7/82 - p. 2

In preparation of our schedule we have allocated what we believe to be sufficient, although tight, timeframes to each step of this process. Compass Consulting Group, in a legislatively mandated consultant study, recommended a 35-month schedule. While we have adjusted the consultant's recommendations regarding the timing of incremental steps of the procurement to allow more time for contractor transition and State acceptance testing, we have maintained the overall schedule at 33 to 35 months (depending if the contingency is needed). This schedule represents our estimated times needed for each step of the process.

#### PROCUREMENT PROJECT STATUS

At this time, the MCPP is on schedule. The Summary Preview document is currently being printed and is scheduled to be released October 12, 1982. While there is much work to be done, through the cooperation of many parties especially the Department of Health Services, we will continue to meet these critical deadlines.

In your report, you cite two Compass Consulting Group milestones which we were delayed in meeting. These were completion of the Computer Science Corporation (CSC) system documentation review by December 1, 1982 and full MCPP staffing by July 1, 1982.

The quality of systems documentation for bidding purposes remains of critical importance to this procurement. A number of steps have been taken to determine the quality of this documentation and to resolve any problems. The Department of Health Services has contracted with Compass Consulting Group (CCG) to, in part, conduct a review of this documentation. CCG has subcontracted with Peat, Marwick, and Mitchell and Company to complete various portions of this contract.

Compass Consulting Group's final assessment of the total documentation for use in both bid and other purposes, will be completed December 17, 1982. This is only 17 days after the recommended schedule and should not delay the procurement. Additionally, the Department of Health Services remains committed to requiring correction of any documentation errors as required by CSC's contract.

As you stated, MCPP was not able to fill all 25 of our positions on July 1, 1982 as recommended by Compass Consulting Group's report. Our project planning did not assume full staffing July 1, as we recognized this as an unreasonable date as commitments to fill nine of our positions could not be finalized until passage of the budget. Even so, we were able to expedite the hiring

process beyond that normally expected on a new project. On July 1, 1982 eighteen of our staff were in place. Incrementally through July the remainder of the Project's staff were hired with complete staffing being achieved August 1, 1982. Failure to achieve full staffing on July 1, 1982 will have no affect on our projected schedule.

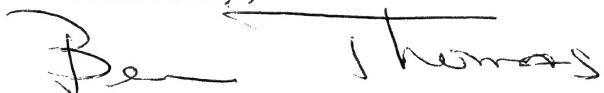
#### RECENT LEGISLATION

The MCPP shares your concern regarding the criticalness of the implementation of Medi-Cal legislation. The RFP and contract will include the planned and orderly implementation of the provisions of this legislation. A large majority of these provisions have been or will be implemented by the Department of Health Services under the current FI contract. Additionally, if necessary, the procurement procedures provide a mechanism for the implementation of any provisions of the law not implemented under the current contract. The RFP can include these changes as a part of the contractor's bid. Even after the RFP is released these changes can be incorporated by addenda or administrative bulletins which revise the RFP.

You have mentioned a number of issues which you consider critical in the next contract including performance standards for the accuracy of claims payment. We continue to welcome the Auditor General's comments in these and other areas and will continue to work closely with your staff.

Once again, I would like to thank you for your efforts. Please direct any questions to me at 322-0753.

Sincerely,



BEN THOMAS, Director  
Medi-Cal Procurement Project

SYNOPSIS OF MAJOR POLICY DECISIONS

Medi-Cal Procurement Project staff research procurement issues and present recommendations to the Policy Advisory Committee, which addresses these policy issues. The Policy Advisory Committee provides its views on these issues, and the MCPP director and the Deputy Director of the Department of Health Services' Fiscal Intermediary Management Division make final decisions. The MCPP staff have identified many major policy issues that affect either the process of procuring the next fiscal intermediary or the terms and conditions of the new contract. Following are brief discussions of some of the important policy decisions that may affect both the procurement process and the new fiscal intermediary contract.

Bidding Method Used To Procure  
The Next Fiscal Intermediary

Bidding methodologies involve processes for releasing a Request for Proposal, for bidders submitting proposals in response to the request, and for the degree and type of interaction between the State and the various bidders. In selecting the current fiscal intermediary, the State used a two-step bidding approach. This approach involves communicating in writing with bidders to clarify and correct proposals. Bidders with acceptable proposals are then issued

an Invitation for Bid. The contract is subsequently awarded to the bidder submitting the lowest-priced proposal. The MCPP director has decided to use the same bidding method for the current procurement process.

Duration of the New Medi-Cal  
Fiscal Intermediary Contract

The current contract with the Computer Sciences Corporation is for five and one-half years, with a provision for extending the contract for up to 12 additional months. The term of the new contract is expected to be five years plus an option for a one-year extension.

Location of the Contractor Site

During the previous procurement process, the Request for Proposal required only that the successful bidder locate its facility in California. The Computer Sciences Corporation, which was awarded the contract, subsequently chose to locate its facilities in Sacramento. The State plans to require the next fiscal intermediary to locate within 25 miles of the State Capitol Building in Sacramento. The Legislative Counsel determined that this requirement is legal. However, the fiscal intermediary will be allowed to maintain certain state-approved activities outside of this 25-mile radius.

**Providing Potential Bidders  
With Information on the  
Edit/Audit Process**

A series of automated edits and audits screen Medi-Cal claims for payment accuracy. Claims that fail edits or audits are suspended from the computer process and are reviewed individually by claims examiners. Information on these edits and audits has been considered privileged because disclosure of such information could encourage questionable billing practices and result in inappropriate Medi-Cal payments. However, in order to develop realistic contract bids, potential bidders must have sufficient information to understand the edit/audit process.

The MCPP staff have recommended that in the current procurement process, bidders will be provided with most edit/audit documentation and programs except for edit tables, reference files, recipient files, and providers files, all of which are confidential. Bidders will be allowed to review the manual that describes how edits and audits are processed, but this review can only be made in the State's data library. Bidders will also be allowed to obtain copies of other documentation, but they will be required to post a \$250,000 financial security refundable when they return the data.

### Turnover of Responsibility for Processing Claims

The turnover phase of the procurement process involves a new contractor's taking over the claims-processing operations from the previous contractor. Because of the large volume of Medi-Cal claims being processed and the complexity of the system, the turnover phase cannot take place immediately; rather, it requires a planned, gradual transition to the next fiscal intermediary. The State experienced many problems during the last turnover of claims processing; these problems were caused mostly by inadequate planning and insufficient time.

To alleviate some of the problems experienced in the past, the State plans to test the entire system fully before the turnover phase begins; such testing was not fully conducted during the last turnover. Also, the next fiscal intermediary will begin processing claims incrementally. For example, drug and long-term care claims will be phased in first, followed later by other types of claims. For each claim type, providers will be instructed to submit claims to the next fiscal intermediary by a specific date that is based on the date that Medi-Cal benefits were rendered.

### Timing and Pricing of Enhancements

Enhancements are modifications to the claims-processing system that are intended to increase the efficiency, economy, and effectiveness of the fiscal intermediary's operations or the Medi-Cal program in its entirety. Major enhancements are frequently generated by legislation. During the transition phase of the procurement process, both the State and the next fiscal intermediary will be focusing their efforts on the turnover of the existing claims-processing system. The MCPP staff have assumed that enhancements will take place after the turnover. However, except under special circumstances, such as enhancements that are legislatively mandated, the MCPP staff have proposed that work on any enhancements by the next fiscal intermediary will not commence until after the system is fully operational.

### The Method Used to Change the Contract or the System

Enhancements and other changes to the system beyond those required by the contract are accomplished through written directives to the fiscal intermediary. These written directives, called "change orders," are usually paid for on a fixed-price basis. After receiving a change order, the fiscal intermediary has 30 days to provide a written pricing proposal and description of the system changes. If necessary, the State

can negotiate a revised price with the fiscal intermediary. In some cases, the DHS may instruct the fiscal intermediary to implement a change before the final price is determined. The fiscal intermediary may appeal the price through a dispute process. The Department of Health Services has experienced problems with the existing change order process, in part, because it has been difficult for the department to audit and thus validate the pricing assumptions made by the fiscal intermediary, and because the contract does not specify schedules for implementing change orders.

According to the FIMD deputy director, the State has issued 33 change orders under the current contract. As of July 16, 1982, only 11 of these had been implemented and another six were cancelled. The average time from issuance to implementation of a change order has been 5.8 months.

The MCPP staff studied New York State's method of implementing changes in its claims-processing system. Based on this review, MCPP staff decided to incorporate into the new contract provisions for a "system development group" composed of a specified number of the fiscal intermediary staff available for the sole purpose of designing, developing, and installing changes to the system. Potential bidders will be required to incorporate price proposals for a system

development group into their bids. Major changes in operations that are not implemented by this group will be accomplished through change orders negotiated after the contract is signed. Additionally, the MCPP staff will specify in the Request for Proposal the basic level of maintenance required as part of the contractor's fixed price.

#### Method of Payment

Under current payment provisions, the State pays the fiscal intermediary a fixed price for the design, development, installation, and turnover of the present claims-processing system. For operations, the State pays a fixed rate for each claim type based on the volume of claim lines processed by the contractor.\*

When the next fiscal intermediary is selected, the State will pay that contractor a fixed price for successfully taking over the system from the current contractor. The new contract will also provide that when the next fiscal intermediary eventually turns over its operations, the State will pay 75 percent of the total amount contracted for the turnover phase until this turnover is completed. At that time, the State will pay the remaining 25 percent.

---

\* A claim line shows the specific charge for a specific medical service. A Medi-Cal claim form can contain a number of claim lines.

As discussed earlier in this report, changes to the new system will be implemented by a system development group and paid for at a fixed rate included in the bid amount. Changes outside the scope of this group will continue to be paid for at a price negotiated by the State. Operations will be paid according to the current fixed-rate method.

Line Item Adjudication Versus  
Claim Document Adjudication

Currently, Medi-Cal claims, except for the inpatient type, are processed by claim line.\* The Medi-Cal claim form may list charges for a number of medical services, but basically, each line on a claim form is processed as an individual claim. Providers are therefore able to receive payment for some claim lines even if others are delayed. However, some providers have experienced problems because of the additional bookkeeping involved in recording several payments made to the same account. Additionally, because the remittance forms sent to the providers do not reconstruct the original claim form, the providers may not know when they have received all payments for a claim document or when to close an account.

---

\* Inpatient claims are paid as an entire claim document because the individual claim lines are interrelated.

The new contract will again require the fiscal intermediary to use line item adjudication for all claim types except for inpatient claims. However, the MCPP staff have not yet decided whether to modify the remittance forms to facilitate reconciliations. The MCPP staff will consider making this modification after the transition to the next fiscal intermediary.

Savings That Result from  
Changes to the System

The current contract states that if the contractor initiates improvements to the claims-processing system that reduce the contractor's expenses, the State and the contractor will share these savings equally for a 24-month period. After that time, the State will receive 100 percent of the savings. However, if the State initiates changes that result in decreased operating expenses, the State receives 100 percent of the savings.

To date, the contractor has not notified the State of any reduced costs resulting from improvements in the system, and the State has not realized any administrative savings resulting from changes initiated by either the State or the contractor.

Provisions in the new contract will allow the contractor to receive 100 percent of any savings resulting from changes that the contractor initiates. However, any such changes must be approved by the State. The savings stemming from state-initiated changes will continue to go only to the State.

#### Liquidated Damages

Provisions for liquidated damages in the current contract require the fiscal intermediary to pay specified amounts to the State in compensation for damage resulting from inadequate performance, late reporting, and other conditions. Because actual damages are difficult or impossible to assess and demonstrate in these cases, rates of compensation for damage are pre-established in the contract.

To date, the State has initiated 48 assessments for liquidated damages against the fiscal intermediary. The majority of these assessments involved inaccurate or untimely reporting by the fiscal intermediary. As of March 1982, the State had assessed over \$3.1 million in liquidated damages, but had collected only \$0.4 million.

In part, the problems experienced by the State in assessing and collecting liquidated damages have occurred because of vague language in the contract. This lack of clarity has led to disputes between the State and the fiscal intermediary regarding the interpretation of contractual responsibility.

The MCPP staff have decided that the new contract should contain stated provisions concerning liquidated damages and that the contracting officer should have discretion in applying these provisions. The MCPP staff plan to correct and clarify existing provisions and, if necessary, expand the coverage of liquidated damages. Additionally, the new contract will include a provision allowing the State to collect interest on liquidated damages that are disputed by the fiscal intermediary but that are later determined to be payable.

#### Medicare Crossover Claims

Approximately 15 percent of Medi-Cal recipients are eligible for benefits under the federal Medicare program. Medi-Cal policy requires that claims for these recipients be submitted first to Medicare for adjudication, then to Medi-Cal for payment of the remaining amount. These are called

"crossover claims." In order to receive payment under the Medi-Cal program, providers of services to Medicare eligibles must first submit a claim to the Medicare program.

Problems exist with these crossover claims because the coding systems in the Medicare and Medi-Cal programs are not totally compatible. Moreover, crossover claims are not comprehensively screened for payment accuracy by the Medi-Cal system's automated edits and audits. Thus, the Medi-Cal payment is contingent upon the Medicare program's determination of whether claims are for necessary and appropriate medical services.

The MCPP staff have considered developing a contract with a separate fiscal intermediary to process both the Medicare and the Medi-Cal portions of crossover claims. However, the Department of Health Services evaluated and identified several complications with this proposal. For example, the Computer Sciences Corporation estimated that the resulting reduction of claim lines would necessitate a renegotiation of the current payment rate. Further, the Health Care Financing Administration recommended that the proposal be pursued as a "demonstration project" only.

Subsequently, the MCPP staff decided that the Medi-Cal fiscal intermediary should continue to process the Medi-Cal portion of crossover claims while the staff consider needed improvements to this process.

State-Owned Components of the Claims-Processing System

Currently, the State owns all computer programs, documentation, manuals, and procedures necessary to operate the Medi-Cal claims-processing system. However, the State does not own the computer, the processing machinery, or the physical plant used by the fiscal intermediary. This arrangement will be continued in the next contract.

Performance Standards for Payment Accuracy

Although the MCPP staff have not decided whether to require standards for accuracy in paying claims, we believe that this is an important issue that should be considered by the MCPP. The Fiscal Intermediary Management Division is responsible for ensuring that the fiscal intermediary fulfills its contractual obligations. As discussed earlier in this report, the State has contracted with a consultant, the Compass Consulting Group, Inc., to assist the Fiscal Intermediary Management Division in carrying out its monitoring responsibility. The consultant is expected to provide the

State with a more effective monitoring plan, which in part will include a review of the fiscal intermediary's accuracy in paying claims. However, the current contract does not include standards for payment accuracy. Moreover, the current fiscal intermediary is responsible only for recovering erroneous payments. The current contract states as follows:

It shall be incumbent upon the Contractor to provide a systematic means for recouping program dollars paid in error, regardless of the source of the error, and other recoveries. The Contractor shall employ A/R [Accounts Receivable] or other appropriate means sanctioned by the State to accomplish due recoveries and modify applicable histories.

In some areas, the State requires the fiscal intermediary to perform according to specific operational standards in order to avoid being assessed for liquidated damages. However, we believe there is little incentive for the fiscal intermediary to process claims accurately. Instead, the fiscal intermediary is encouraged to process claims rapidly because payment is maximized by high volume processing. As discussed in a previous Auditor General report, the inaccurate payment of claims by the fiscal intermediary can cost the Medi-Cal program millions of dollars.\* In that report, which

---

\* See the Auditor General's report entitled, The CSC Has Authorized At Least \$12.6 Million In Recoverable Medi-Cal Overpayments That An Improved Quality Assurance Program May Have Detected," Report P-044, September 1981.

was a very limited review, we found that the fiscal intermediary had made erroneous payments of between \$12.6 and \$25.3 million. The Compass Consulting Group also found the current contract deficient in regard to accuracy standards and therefore recommended that the State develop performance standards for the accurate payment of claims. The consultants emphasized that the correctness of payment--measured as a dollar error rate or percentage of total payments--is fundamental to the integrity and economy of the Medi-Cal program.

Although there are currently no federal requirements for such standards, there are standards for payments made in the Aid to Families with Dependent Children Program. An official in the Region IX office of the Health Care Financing Administration also stated that there is no federal objection to the State's including performance standards for payment accuracy in the new contract.

If the MCPP were to develop performance standards for the accurate payment of claims, the Fiscal Intermediary Management Division could use any of several resources available in monitoring the fiscal intermediary's compliance with these standards. For example, the Department of Health Services' Medi-Cal quality control program currently performs various accuracy reviews of sample Medi-Cal claims. Also, at

the conclusion of our review of claims payment accuracy (Report P-044), we provided the Fiscal Intermediary Management Division with computer software used to identify erroneous payments. With modification, we believe these and similar programs could be used for automated reviews of paid claims. In addition, the Compass Consulting Group is developing a plan to review the accuracy of payments made by the fiscal intermediary.

We have shared our concerns about accuracy standards with management personnel of both the Fiscal Intermediary Management Division and the Medi-Cal Procurement Project. Although they agree with the need for accurately paid claims, the management personnel cited three reasons that have kept them from developing standards for payment accuracy in the new Request for Proposal. First, the Department of Health Services has not had adequate staff and expertise to monitor such standards. Second, if the fiscal intermediary is held liable for the amount of all overpayments, the financial risk involved could discourage bidding on the new contract. Moreover, the bids submitted would be higher to offset the risk. Third, such standards may not be necessary because the fiscal intermediary is interested in preserving its professional reputation and will therefore endeavor to pay claims accurately. This may not

always be the case, however. For example, the State of Tennessee initiated action to cancel the contract of its fiscal intermediary because, among other reasons, state officials believed that the contractor failed to process claims accurately.

Despite management personnel's reservations about including performance standards, we recommend that they continue to consider the need for performance standards applicable to the accuracy of payments made by the fiscal intermediary.

cc: Members of the Legislature  
Office of the Governor  
Office of the Lieutenant Governor  
State Controller  
Legislative Analyst  
Director of Finance  
Assembly Office of Research  
Senate Office of Research  
Assembly Majority/Minority Consultants  
Senate Majority/Minority Consultants  
Capitol Press Corps